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SCURRY – RAINBOW OIL LIMITED

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1965 ANNUAL REPORT

SCURRY-RAINBOW OIL LIMITED

539 EIGHTH AVENUE S.W., CALGARY, ALBERTA

INCORPORATED UNDER THE LAWS OF THE PROVINCE OF ALBERTA
FEBRUARY 5, 1954

BOARD OF DIRECTORS

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JOHN F. LANGSTON
E. GEORGE MESCHI
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LAWRENCE C. MORRISROE
FRANK E. TAPLIN, M.B.E.

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President

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Executive Vice-President

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Vice-President

P. ABT
Assistant Vice-President

E. H. CHARKO, C.A.
Treasurer & Assistant Secretary

M. E. JONES, Q.C.
Secretary

REGISTRAR & TRANSFER AGENTS

GUARANTY TRUST COMPANY OF CANADA
Calgary, Alberta — Toronto, Ontario — Montreal, Quebec

THE CANADIAN BANK OF COMMERCE TRUST COMPANY
20 Exchange Place, New York, N.Y.

STOCK LISTINGS

AMERICAN STOCK EXCHANGE

TORONTO STOCK EXCHANGE

AUDITORS

PRICE WATERHOUSE & CO.
Calgary, Alberta

All references to "Scurry-Rainbow" and "the Company" in this report, except where the context otherwise indicates, refer to Scurry-Rainbow Oil Limited and its subsidiary companies.

ANNUAL MEETING

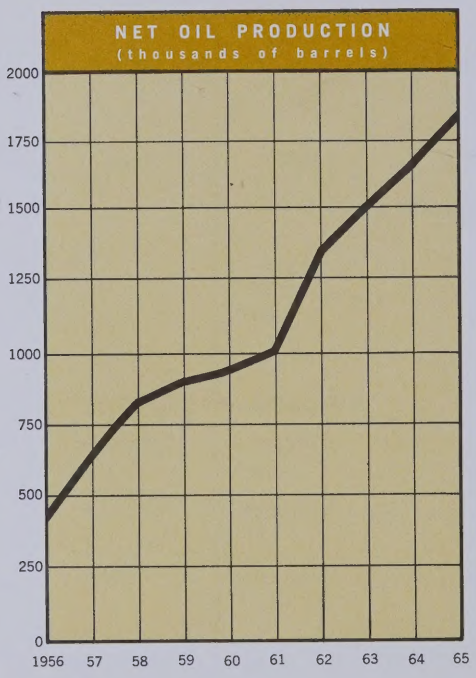
The 1966 annual meeting of shareholders will be held Saturday, February 26, at 10:00 a.m., at the Head Office of the Company, 539 Eighth Avenue S.W., Calgary, Alberta, Canada. A formal notice of this meeting, together with proxy statement and form of proxy, is being mailed with this report. All shareholders who are unable to attend the meeting are urged to sign and return their proxies as soon as possible.

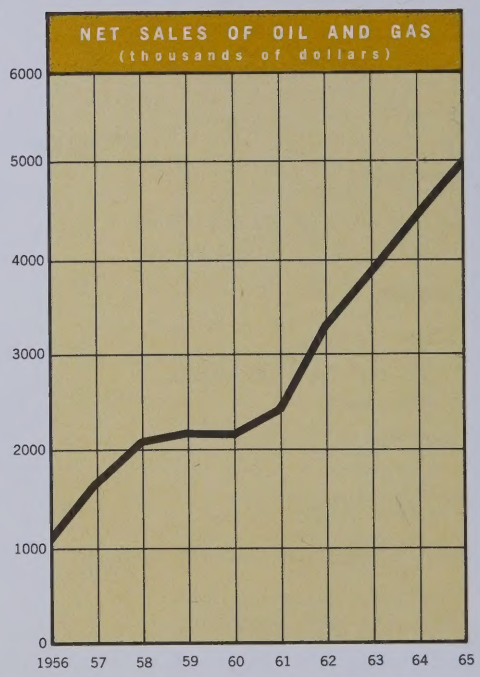
THE REPORT IN BRIEF

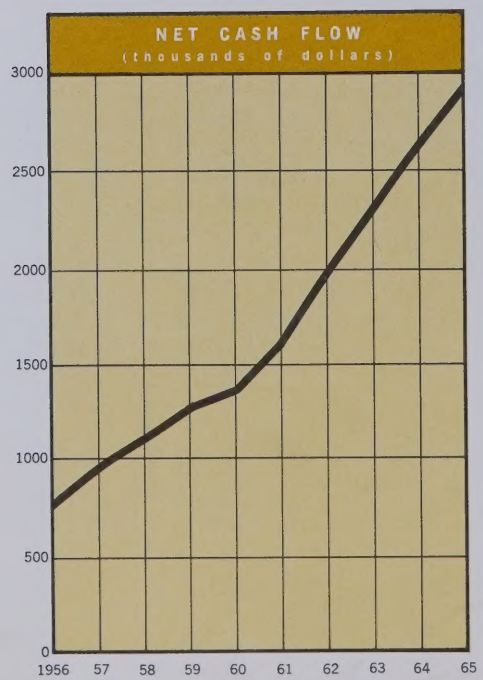
	1965	1964
OPERATIONS FOR THE YEAR		
PRODUCTION		
Crude oil — net barrels per day	5,005	4,460
Natural gas — net mcf per day	7,685	6,080
FINANCIAL		
Gross revenue	$ 5,184,981	$ 4,863,217
Cash flow from operations	2,942,803	2,640,500
per share	1.48	1.34
Net earnings	1,325,869	1,178,631
per share	.67	.60
Capital expenditures	$ 5,755,126	$ 4,799,165
WELLS DRILLED ON COMPANY ACREAGE		
Successful oil and gas wells	68	59
Wells dry and abandoned	47	56
YEAR-END POSITION		
FINANCIAL		
Funds on hand	$ 2,418,682	$ 2,292,960
Long term debt due within one year	1,625,000	1,515,000
Working capital	793,682	777,960
Total long term debt	$15,567,500	$12,707,500
Shares outstanding	1,989,677	1,977,183
LAND HOLDINGS		
Total gross acreage	8,224,085	11,569,211
Net working interest acreage	2,583,419	2,398,635
Net mineral acreage	1,360,639	1,343,289
Net royalty interest acreage	146,187	190,151
OIL AND GAS WELLS		
Total gross wells	3,832	3,713
Net working interest wells	155.55	129.92
Net royalty interest wells	186.31	170.23

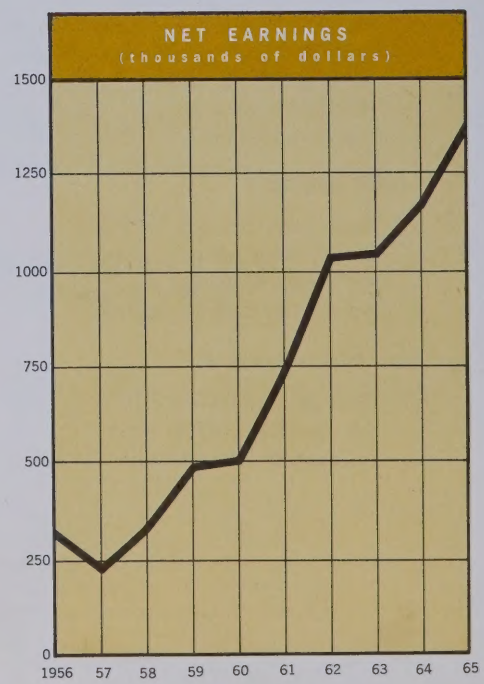
SCURRY-RAINBOW OIL LIMITED

GROWTH TREND
1956 - 1965









To the Shareholders:

Your directors are pleased to report that 1965 was a year of significant oil and gas discoveries and continued growth in production, sales, cash flow and earnings for Scurry-Rainbow Oil Limited.

The 1965 exploratory drilling program of the Company has been one of the most successful on record, having resulted in new oil discoveries in the Osprey and Weasel areas of Northeastern British Columbia and at Lake Alma, Flat Lake, North Midale and Innes in Southeastern Saskatchewan. In addition to these discoveries a significant extension was made to the Gold Creek wet-gas pool in Northwestern Alberta. By reason of these discoveries capital expenditures in 1965 were considerably increased over capital expenditures in the previous year. Total expenditures for finding and developing oil and gas reserves amounted to $5,306,000, an increase of 35% over 1964. Of this amount, $2,310,000 was spent for exploratory and development drilling, $2,120,000 for the acquisition of additional acreage and $876,000 for other exploration and land retention costs. The major portions of both the drilling and acreage expenditures were incurred in the Peejay-Nancy area of Northeastern British Columbia, the Gold Creek area of Northwestern Alberta and in the areas surrounding the new oil discoveries in Southeastern Saskatchewan. The overall exploratory and development drilling program added 20.24 net working interest oil wells and 2.20 net working interest gas wells in 1965 to the production capacity of the Company.

In 1965 net production of crude oil increased 12% to 5,005 barrels per day and net production of natural gas increased 26% to 7,685 mcf per day. Gross revenue amounted to $5,185,000 and resulted in a cash flow of $2,943,000 from operations equivalent to $1.48 per share, an increase of 11% over the previous year. After giving effect to the adoption of the full cost method of accounting for oil and gas properties, referred to in the financial section of this report, consolidated net earnings amounted to $1,326,000 or 67¢ per share, an increase of 12% over the net earnings reported for 1964 under the previous accounting method. The full cost method of accounting, which is now followed by a number of major and independent oil and gas companies in Canada, has the effect of amortizing the total costs of finding and developing oil and gas reserves in a systematic manner over the life of those reserves, with the result that annual earnings bear a close relationship to annual sales of crude oil and natural gas production.

On January 10, 1966 the Company issued $7,500,000 principal amount of 6¼% Convertible Subordinated Debentures pursuant to an underwriting agreement with Dominion Securities Corporation Limited dated December 21, 1965, which provided for the sale of these debentures through a public offering in Canada. Subject to the adjustment of the conversion price in specified events, the debentures are convertible into shares of the Company at any time before December 15, 1970 at $20.00 per share and thereafter at any time before December 15, 1975 at $25.00 per share. The debentures are subordinated to

all senior indebtedness of the Company and are redeemable by annual sinking fund payments of $400,000 commencing on June 15, 1971 with the balance due at maturity on December 15, 1985.

The proceeds of this debenture issue amounting to $7,275,000 have placed the Company in a sound financial position with working capital of approximately $7,500,000 at January 31, 1966. With these financial resources, the Company is in an excellent position to carry out its exploratory and development programs in those areas where previous drilling and other work have indicated attractive opportunities for success. In 1966 this activity will be concentrated mainly in the Peejay-Nancy area of British Columbia, the Gold Creek area of Alberta and in Southeastern Saskatchewan.

Scurry-Rainbow's extensive mineral holdings in the potash area of Saskatchewan have placed the Company in a position to gain substantial potash revenue in the future. The Company is currently negotiating with a number of major potash producers for the development of certain of its mineral properties with a reserved royalty to Scurry-Rainbow and it is expected that agreements in this regard will be finalized during the coming year. In addition to its extensive freehold mineral interests throughout the Saskatchewan potash belt, Scurry-Rainbow also holds 400,000 acres of Crown potash exploration permits on which geological and geophysical studies have indicated the possibility of potash reserves and on which the Company is currently drilling its initial exploratory test. The feasibility of entering into the production of potash is under active consideration by Scurry-Rainbow, and the results of its exploratory drilling and other acquisitions will determine the future course to be taken in this regard.

By virtue of a ruling of the Internal Revenue Service of the U.S. Treasury Department dated December 30, 1964, Scurry-Rainbow stock is exempt from the 15% Interest Equalization Tax. This exemption places Scurry-Rainbow in a preferred position from the standpoint of American and Canadian investors who may wish to participate in the Western Canadian Oil Industry, since neither vendors nor purchasers of Company stock come within the application of this tax.

Your directors express sincere appreciation to the shareholders for their continued interest in the affairs of the Company and to the employees for their support and co-operation which made possible the progress of the Company in the past year.

Frank E. Taplin
Chairman of the Board

E. George Mesch
President

Calgary, Alberta, Canada
January 31, 1966

EXPLORATION AND DEVELOPMENT

Scurry-Rainbow's 1965 drilling program has been one of the most successful in the Company's history. A total of 115 wells were drilled on Company acreage, the results of which are summarized as follows:

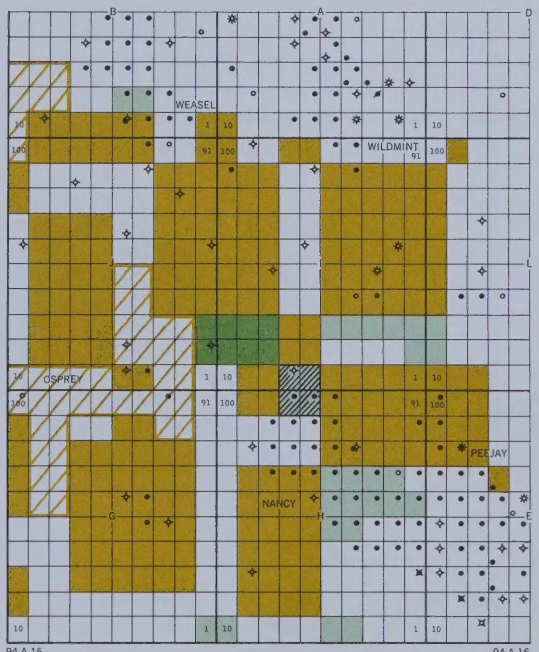
	Oil	Gas	Dry	Total
British Columbia	17	1	11	29
Saskatchewan	45	–	23	68
Alberta	–	4	13	17
Manitoba	1	–	–	1
TOTAL	63	5	47	115

Scurry-Rainbow paid its proportionate share of the drilling costs of 70 of these wells while the remaining 45 wells were drilled under farmout agreements or on royalty acreage at no cost to the Company. The Company's drilling programs in the Peejay-Nancy area of British Columbia, the Gold Creek area of Alberta and the general Lake Alma and Innes areas of Southeastern Saskatchewan have been of particular importance to the Company. The new wells completed in these areas during the past year have contributed significantly to the overall increase in Company reserves and productive capacity. Scurry-Rainbow, by reason of its extensive land holdings in Southeastern Saskatchewan, has been able to participate in an extensive exploration program in this area at a relatively small cost to the Company. This was accomplished through farmouts, acreage contributions, options and dry-hole contributions which encourage other operators to drill exploratory wells on or offsetting Company acreage. Through these agreements a further 38 wells were drilled offsetting Company acreage, five of which resulted in new oil discoveries, the most important being the discovery well for the prolific Innes pool in Southeastern Saskatchewan.

BRITISH COLUMBIA

Scurry-Rainbow's drilling activity in Northeastern British Columbia was concentrated on its large acreage spread in the Peejay-Nancy area approximately 45 miles north of Fort St. John. A total of 29 wells were drilled on Company acreage in British Columbia resulting in 17 oil wells, 1 gas well and 11 dry holes. Ten development wells were completed in the Peejay-Nancy pool in which the Company holds varying working interests equivalent to 3.8 net wells. Two development wells were completed in the Weasel pool in which the Company has a 50% working interest and 1 well was completed in the Wildmint pool in which the Company has a 22% working interest. Company exploratory activity in this general area resulted in a new discovery at Osprey. Follow-up drilling to this discovery has resulted in one more oil well and two dry holes. Scurry-Rainbow holds a 22% working interest in the Osprey wells.

The oil production in this whole general area is being derived from the prolific Triassic-D Halfway sands. Production allowables, depending upon well capability, have ranged as high as 400 barrels of oil per day.



PEEJAY and NANCY AREAS of BRITISH COLUMBIA

- LOCATION
- OIL WELL
- GAS WELL
- OIL & GAS WELL
- DRY HOLE

- SCURRY-RAINBOW — 22% WORKING INTEREST
- SCURRY-RAINBOW — 44 1/2% WORKING INTEREST
- SCURRY-RAINBOW — 50% WORKING INTEREST
- SCURRY-RAINBOW — 100% WORKING INTEREST
- DRILLING RESERVATIONS — SCURRY-RAINBOW — 22% WORKING INTEREST

During the year the Company acquired varying working interests in a further 21,462 gross acres in the Peejay-Nancy area equivalent to 5,611 net acres for a total cash consideration of $290,254. The fact that there is no proration to market in Northeastern British Columbia provides an added incentive for drilling in this area. Scurry-Rainbow presently holds working interests varying from 22% to 100% in over 75,000 acres of petroleum and natural gas rights in this area and is carrying out a continuous exploratory and development drilling program in the area.

SASKATCHEWAN

Scurry-Rainbow again had a very active year in the Province of Saskatchewan. A total of 68 wells were drilled on Company acreage resulting in 45 oil wells and 23 dry holes. The Company paid its proportionate share of the costs of 29 of these wells while the balance were drilled at no cost to the Company under farmout agreements or on royalty acreage. A further 30 wells were drilled by other operators on acreage offsetting Company holdings pursuant to option or dry-hole agreements with the Company. Acquisitions of petroleum and natural gas acreage during the year totalled over 120,000 net acres for an aggregate cash consideration of $528,372. The main drilling program of Scurry-Rainbow in Saskatchewan was carried out in the Lake Alma, Flat Lake, North Midale and Innes oil fields, details and maps of which appear below.

North Midale

In the North Midale field, Scurry-Rainbow completed three more Midale Beds oil wells and made a significant new discovery in the Bakken zone approximately 1,000 feet below the Midale Beds. Scurry-Rainbow has a 66⅔% interest in this Bakken discovery and a 100% interest in the 3 Midale Beds wells. Follow-up drilling to the Bakken has failed to enlarge this pool. However, further drilling is contemplated during the coming year.

Innes

During the year a very significant discovery was made at Innes a few miles north of the Midale field. Since September 30, 1965 six wells in which Scurry-Rainbow holds varying interests ranging from 40% to 80% have been completed. These wells are producing from the Frobisher Beds with net pay sections varying from 30 to 60 feet. Producing characteristics are excellent and initial allowables will average over 100 barrels of oil per day per well. Scurry-Rainbow has extensive acreage holdings along this new producing trend and plans an extensive exploratory and development drilling program on this acreage in 1966.

Lake Alma - Flat Lake

Scurry-Rainbow participated in the drilling of 2 new oil discoveries on acreage held in the general Lake Alma area of Southern Saskatchewan. The Lake Alma discovery at 2-29-1-17W2 encountered over 40 feet of oil pay in the Oungre zone of the Mississippian. Three follow-up wells have also resulted in excellent producers while a fourth has been abandoned. The accompanying map shows Scurry-Rainbow's acreage holdings in this area.

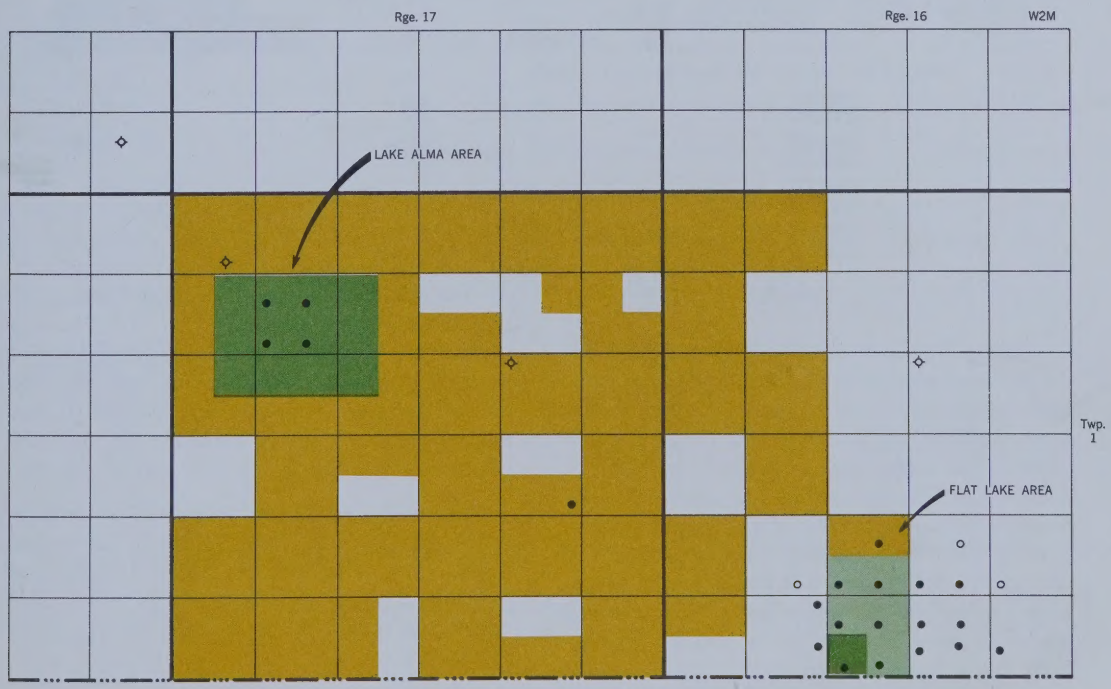
The second oil discovery was made approximately 7 miles southeast of the Lake Alma pool in the Flat Lake area. A total of 7 wells have been completed in this pool in which the Company has varying interests (see map). The wells in this pool are being completed in the

Ratcliffe zone of the Mississippian. The average production allowables for the Company's wells in this pool will exceed 100 barrels of oil per day per well.

Additional development drilling was carried out in the Browning and Queensdale areas. Three wells were completed in the Browning area in which Scurry-Rainbow holds a 50% working interest. Five wells were completed in the Queensdale area in which the Company holds varying working interests equivalent to 1.4 net wells.

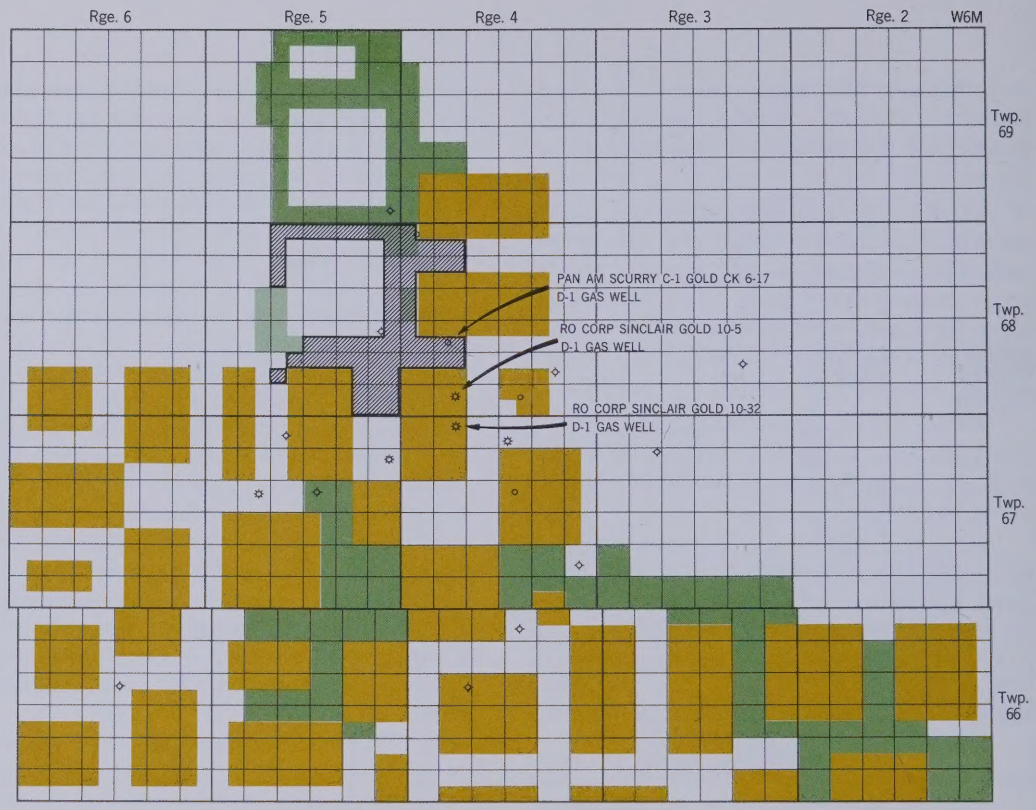
Overall exploratory and development drilling in Saskatchewan added 14.49 net working interest wells to Scurry-Rainbow's productive capacity during the year.

Scurry-Rainbow's extensive spread of mineral holdings in Saskatchewan continues to be a prime factor in the Company's growth. It will be seen on page 10 of this report that Saskatchewan is now contributing over 50% of the Company's total oil production. Prospects for the future appear to be just as promising. Following the results of two new discoveries in deeper horizons, a whole new area of this province has been reviewed by the oil industry for renewal of exploratory drilling. One of the two new discoveries which created this renewed exploration emphasis was the Bakken discovery made by Scurry-Rainbow at Midale while the other was a Keg River reef discovery in Northwestern Alberta. Following these two discoveries, over eight million acres of exploration permits were acquired by other oil companies in Saskatchewan and a large number of wildcat wells have already been drilled in the new areas. Although none of these wells have resulted in commercial discoveries, significant oil shows have been encountered and important new geological information has been obtained. Scurry-Rainbow has extensive freehold mineral holdings spread throughout these new areas of interest and will thereby be in a good position to benefit from any new discoveries. The Company plans to participate directly and through farmout agreements in this new exploratory activity.



LAKE ALMA and FLAT LAKE AREAS of SASKATCHEWAN

- LOCATION
- OIL WELL
- DRY HOLE
- SCURRY-RAINBOW 18.75% WORKING INTEREST
- SCURRY-RAINBOW 37.5% WORKING INTEREST
- SCURRY-RAINBOW 28.125% WORKING INTEREST



WAPITI SMOKY and CUTBANK RIVER AREAS of ALBERTA

- LOCATION
- OIL WELL
- GAS WELL
- DRY HOLE
- SCURRY-RAINBOW DRILLING RESERVATIONS — 50%
- SCURRY-RAINBOW LEASES — 16 2/3% NET CARRIED INTEREST
- SCURRY-RAINBOW NATURAL GAS LICENSE — 50%
- SCURRY-RAINBOW LEASES — 50%

ALBERTA

During the fiscal year 17 wells were drilled in the Province of Alberta in which Scurry-Rainbow held varying interests. Four of these wells were completed as gas wells and 13 were abandoned. The major area of interest for Scurry-Rainbow in Alberta continues to be the Wapiti-Smoky and Cutbank River areas of Northwestern Alberta where the Company holds a 16⅔% net carried interest in over 422,400 acres of petroleum and natural gas leases and a 50% working interest in over 57,760 acres of drilling reservations and natural gas leases. It is in this area where the huge Gold Creek wet-gas pool is being developed. A total of 5 gas wells have now been completed in this field, 3 of which are located on Company acreage. The main producing reservoir in this field is the D-1 section of the Devonian.

The Pan Am Scurry C-1 Gold Creek 6-17 well in which the Company holds a 50% working interest was completed at a depth of 11,000 feet in the D-1 section of the Devonian with over 200 feet of gas pay. During tests this well flowed natural gas at 9.7 million cubic feet per day with condensate rates of up to 453 barrels per day.

The RO Corp Sinclair Gold 10-32 well in which the Company holds a 16⅔% net carried interest was completed in the D-1 with over 460 feet of gross pay. Tests of this well yielded 9.4 million cubic feet of gas and 1,296 barrels of condensate per day.

Since the fiscal year end, the RO Corp Sinclair Gold 10-5 well in which the Company holds a 16⅔% net carried interest was also completed in the D-1. This well tested gas at rates of up to 18 million cubic feet per day with a heavy condensate spray. Further tests are continuing.

A continuous development drilling program is now in progress with 3 rigs currently active in this field. This program should delineate the outer limits of this pool sufficiently by the end of 1966 to make final plans to place it on production in 1967.

Following the successful drilling results in this area, Scurry-Rainbow participated with Pan American Petroleum Corporation in the acquisition of 3 more drilling reservations comprising a total of 34,720 acres. Scurry-Rainbow's costs for its 50% interest in these drilling reservations totalled $1,011,770.

In the Hairy Hill area, approximately 80 miles northeast of Edmonton, Scurry-Rainbow made a triple zone sweet-gas discovery. Individual tests of the 3 zones indicated natural gas rates of 12.8, 5.8 and 8.8 million cubic feet per day respectively. The Company has a 100% interest in this discovery and in over 5,000 acres of petroleum and natural gas rights in this area. In the East Crossfield gas field Scurry-Rainbow completed a dual zone gas well which tested gas at rates of 4 and 21 million cubic feet per day respectively. The Company holds a 50% working interest in this well.

SUMMARY OF OIL AND GAS WELLS

SEPTEMBER 30, 1965

	Alberta	British Columbia	Saskatchewan	Manitoba	Total Sept. 30/65	Total Sept. 30/64
GROSS NUMBER OF WELLS						
Oil wells	1,449	209	1,931	42	3,631	3,524
Gas wells	164	37			201	189
TOTAL	1,613	246	1,931	42	3,832	3,713
NET WORKING INTEREST WELLS						
Oil wells	48.24	17.64	66.19	8.41	140.48	118.99
Gas wells	11.17	3.90			15.07	10.93
TOTAL	59.41	21.54	66.19	8.41	155.55	129.92
NET ROYALTY INTEREST WELLS						
Oil wells	29.67	.03	149.29	.93	179.92	166.45
Gas wells	5.87	.52			6.39	3.78
TOTAL	35.54	.55	149.29	.93	186.31	170.23

One gross well represents a well in which the Company has any interest, including all wells operated under unit agreements.

One net working interest well represents the full working interest ownership in one well, or the ownership of fractional working interests in several wells aggregating the equivalent of the full working interest ownership in one well.

One net royalty interest well represents the right to the equivalent of one-eighth of the production from one well, without deduction for development or operating expenses.

PRODUCTION

Net Production of Oil	1965	1964
Alberta	493,583	533,146
British Columbia	350,249	174,621
Saskatchewan	955,068	891,384
Manitoba	28,296	33,004
Total barrels	1,827,196	1,632,155
Barrels per day	5,005	4,460

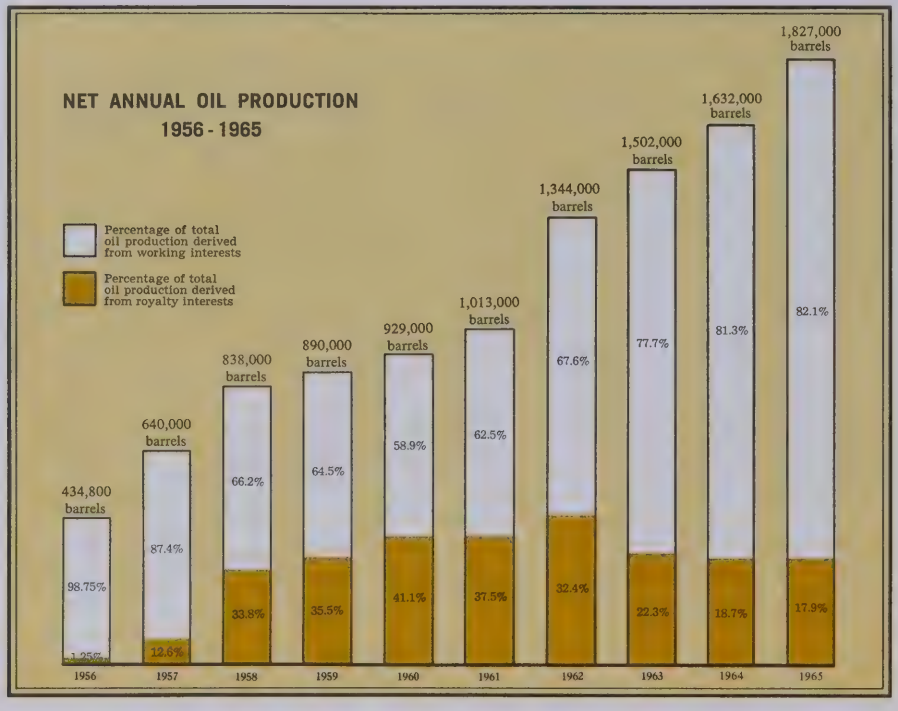
Net Production of Gas	1965	1964
Alberta	2,533,121	2,094,451
British Columbia	272,806	131,295
Total mcf	2,805,927	2,225,746
Mcf per day	7,685	6,080

Net Sales of Oil and Gas	1965	1964
Crude oil	$4,303,404	$3,982,823
Natural gas and by-products	688,674	480,230
Total dollars	$4,992,078	$4,463,053

The continuous upward trend in production was maintained and new levels of production were established by Scurry-Rainbow in 1965. Net production of crude oil totalled 1,827,196 barrels equivalent to 5,005 barrels per day, an increase of 12% over 1964. Net production of natural gas was 2,805,927 mcf equivalent to 7,685 mcf per day which represents an increase of 26% over the previous year.

During the past several years the Company has increased its exploratory and development activity in the Provinces of British Columbia and Saskatchewan in order to take advantage of the unrestricted market allowables for oil production in those provinces. The success of this policy is reflected in the increasing proportion of total oil production derived from British Columbia and Saskatchewan. Because of this production diversification, the depressing effect of reduced Alberta allowables has not had a corresponding effect on the Company's overall oil production.

Production of natural gas continues to contribute an increasing percentage of overall Company revenue. In 1965 sales of natural gas and by-products amounted to $688,674 which represents 14% of total sales as compared with $480,230 in 1964 which was equivalent to 11% of total sales during the previous year.



FINANCIAL REVIEW

Effective October 1, 1964 the Company adopted the "full cost" method of accounting for oil and gas properties whereby all expenditures relating to the exploration for and development of oil and gas reserves are deemed to represent the cost of proven reserves established by the Company to date and are capitalized accordingly. Contrary to the accounting practice previously followed, acquisition, exploration and development costs are not assigned to specific petroleum and natural gas properties; consequently, dry hole costs, abandonments of individual properties and normal sales of unproductive properties, none of which involve any change in proven reserves, are no longer reflected as gains or losses in the earnings statement, nor is depletion restricted to those costs which may be identified with producing properties only. Under the full cost concept, annual depletion of petroleum and natural gas properties is provided upon all unamortized costs to date in the proportion that the total annual production bears to the total estimated proven reserves of oil and gas and other saleable products.

During the 1965 fiscal year consolidated net earnings amounted to $1,325,869 equivalent to 67¢ per share, an increase of 12% over the net earnings reported for the previous year. The consolidated earnings statement of the Company for 1965 calculated on the full cost accounting method and for 1964 calculated on the previous accounting method is condensed hereon. Although the adoption of the full cost accounting method did not involve the revision of net earnings reported for prior years, it necessitated a recalculation of cash flow for previous years and the comparative figures for 1964 have been reclassified accordingly.

Earnings Summary	1965 (thousands of dollars)	1964 (thousands of dollars)	Increase (decrease)
Net sales of oil and gas	$4,992	$4,463	12%
Other income	193	400	(52%)
Gross revenue	5,185	4,863	7%
Operating expenses	1,470	1,592	(8%)
Interest on long term debt	772	631	22%
Cash flow	2,943	2,640	11%
Depletion and depreciation	1,443	1,056	37%
Other charges	174	405	(57%)
Net earnings	$1,326	$1,179	12%
Amounts per share			
Cash flow	$ 1.48	$ 1.34	11%
Net earnings	.67	.60	12%

Capital expenditures increased 20% over the previous year for a total of $5,755,126 in 1965 of which $5,305,984 was spent for finding and developing oil and gas reserves. A summary of capital expenditures in 1965 with comparison to capital expenditures in 1964 is tabulated below:

Capital Expenditures	1965 (thousands of dollars)	1964 (thousands of dollars)	Increase (decrease)
Acreage acquisitions	$2,120	$2,192	$ (72)
Exploratory and development drilling	2,310	1,224	1,086
Exploratory surveys and projects	259	137	122
Rentals and other carrying charges	617	390	227
	5,306	3,943	1,363
Production and other equipment	449	856	(407)
Total expenditures	$5,755	$4,799	$ 956

TEN-YEAR SUMMARY

(thousands of dollars)

	1965	1964	1963	1962	1961	1960	1959	1958	1957	1956
Net sales	$4,992	4,463	3,845	3,336	2,398	2,143	2,166	2,086	1,643	1,108
Cash flow	$2,943	2,640	2,298	1,997	1,613	1,355	1,274	1,100	962	763
Net earnings	$1,326	1,179	1,040	1,023	719	492	488	322	217	316

CONSOLIDATED BALANCE SHEET

ASSETS

	1965	1964
CURRENT ASSETS:		
Cash	$ 2,592,572	$ 2,758,802
Government of Canada bonds, at cost	—	24,618
Accounts receivable	801,728	798,915
Inventories—		
Crude oil, at market (Note 1)	—	30,455
Materials and supplies, at cost	77,955	83,050
Prepaid expenses	67,714	93,746
	3,539,969	3,789,586
INVESTMENTS AND OTHER ASSETS:		
Investments, at cost—		
Shares of Minerals Ltd., 50% owned	2,211,830	2,211,830
Securities of other companies	414,500	1,216,239
Shares of a subsidiary company not consolidated, at cost	10,000	10,000
Deposits and advances	144,961	77,243
	2,781,291	3,515,312
CAPITAL ASSETS, at cost: (Note 1)		
Petroleum and natural gas and other mineral interests	38,288,461	32,135,865
Less—Accumulated depletion	(6,555,433)	(5,359,252)
Mining claims, non-producing	653,643	414,092
Production equipment	3,841,912	3,555,368
Other capital assets	1,927,451	1,791,435
Less—Accumulated depreciation	(2,056,840)	(1,881,634)
	36,099,194	30,655,874
DEFERRED CHARGES:		
Organization and share issue expense	247,567	230,797
Other charges, less amortization	124,025	134,086
	371,592	364,883
	$42,792,046	$38,325,655

AT SEPTEMBER 30, 1965

LIABILITIES

	1965	1964
CURRENT LIABILITIES:		
Accounts payable and accrued charges	$ 1,121,287	$ 1,496,626
Long term debt due within one year	1,625,000	1,515,000
	2,746,287	3,011,626
LONG TERM DEBT:		
Bank loan at current rate of interest (secured), repayable $125,000 in October 1965 and thereafter $135,000 per month	15,500,000	12,625,000
5% Mortgage due January 1, 1970, repayable $3,750 per quarter	67,500	82,500
	15,567,500	12,707,500
Less—Amounts due within one year	1,625,000	1,515,000
	13,942,500	11,192,500
MINORITY INTERESTS in subsidiary companies	2,395,460	1,910,009
SHAREHOLDERS' EQUITY:		
Share capital—(Note 2)		
Authorized—7,500,000 shares of a par value of $3.50 each		
Issued—1,989,677 shares	6,963,870	6,920,140
Contributed surplus—(Note 2)	10,801,759	10,675,079
Retained earnings, per statement attached	5,942,170	4,616,301
	23,707,799	22,211,520
SIGNED ON BEHALF OF THE BOARD:		
J. F. LANGSTON, Director		
L. C. MORRISROE, Director		
	$42,792,046	$38,325,655

The Auditors' Report is attached to this Balance Sheet.

SR

CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS

FOR THE YEAR ENDED SEPTEMBER 30, 1965

	1965	1964
Sales, less royalties	$ 4,213,304	$ 3,706,215
Royalty income	778,774	756,838
Claims awarded for production income	109,148	125,156
Investment and other income	83,755	275,008
	5,184,981	4,863,217
Production expenses	903,626	815,233
Administrative and general expenses (Note 1)	565,939	776,747
Interest on long term debt	772,613	630,737
	2,242,178	2,222,717
Cash flow from operations	2,942,803	2,640,500
Depletion and depreciation (Note 1)	1,442,549	1,056,431
Dry holes and abandonments, less profit on sale of properties (Note 1)	—	270,648
Mining claims abandoned	36,243	44,401
Other charges—net	92,481	34,868
Minority interests in net earnings of subsidiaries	45,661	55,521
	1,616,934	1,461,869
Net earnings for the year	1,325,869	1,178,631
Retained earnings at beginning of year	4,616,301	3,437,670
Retained earnings at end of year	$ 5,942,170	$ 4,616,301

CONSOLIDATED STATEMENT OF SOURCE AND USE OF FUNDS

FOR THE YEAR ENDED SEPTEMBER 30, 1965

	1965	1964
Funds were derived from:		
Operations	$ 2,942,803	$ 2,640,500
Long term bank loans	4,398,000	13,500,000
Disposal of Company stock—		
Shares issued from treasury	170,410	1,600
Shares held by a subsidiary	—	991,312
Other sources	162,205	244,693
	7,673,418	17,378,105
Add—Funds at beginning of year	2,292,960	3,430,607
	9,966,378	20,808,712
Funds were utilized for:		
Acquisition of property	2,119,741	2,192,502
Exploration and development	3,186,243	1,750,763
Purchase of equipment	449,142	855,900
Acquisition of shares in—		
Subsidiary companies	96,012	284,419
Other companies	29,136	897,360
Redemption of long term debt	1,538,000	12,492,717
Other purposes	129,422	42,091
	7,547,696	18,515,752
Funds remaining at end of year	2,418,682	2,292,960
Less—Long term debt due within one year	1,625,000	1,515,000
Working capital at end of year	$ 793,682	$ 777,960

SR

NOTES TO FINANCIAL STATEMENTS

1. CHANGES IN ACCOUNTING PRACTICES:

Prior to October 1, 1964 the companies followed the practice of expensing dry hole costs as incurred, writing off the cost of properties surrendered, and recording profits and losses on properties sold. Property acquisition costs, carrying charges on non-producing properties, geological and geophysical expenses and producing well costs were capitalized. Depletion of producing properties was provided by the unit of production method applied on a field basis. Depreciation of production equipment was provided at appropriate rates by the diminishing balance method.

Effective October 1, 1964 the full cost method of accounting was adopted whereby all costs relating to the exploration for and development of oil and gas reserves, including exploration overhead, are capitalized whether productive or unproductive and proceeds on disposal of properties are ordinarily deducted from costs without recognition of profit or loss. Depletion of oil and gas properties is computed on the total of all such costs by the unit of production method based on the total estimated proven reserves of oil and gas and other saleable products and depreciation of production equipment is computed in a similar manner. This change in accounting for oil and gas properties had the effect of increasing net earnings by $440,325 for the 1965 fiscal year.

During the 1965 fiscal year the practice of recording crude oil inventories in field tanks, which remain fairly constant from year to year, was discontinued and this change in accounting practice had the effect of decreasing net earnings by $31,482 for the current year.

2. SHARE CAPITAL, SHARE OPTIONS AND CONTRIBUTED SURPLUS:

During the fiscal year options on 12,494 shares were exercised and at September 30, 1965 options on 82,615 shares were outstanding in respect of stock options granted in prior years to certain officers and employees for the purchase of shares of the Company at prices of $8.00, $11.75 and $15.05 per share.

The cash consideration for the issuance of 12,494 shares pursuant to stock options exercised in 1965 amounted to $170,410 of which $43,730 was credited to share capital and $126,680 was credited to contributed surplus.

3. INCOME TAXES:

Under Canadian income tax law, drilling and exploration expenses, together with the costs of leases, permits and reservations acquired after April 10, 1962, all of which are now capitalized in the companies' accounts and subsequently amortized, are deducted in computing income as incurred or, if such expenditures exceed the income for the year, the excess is carried forward and applied as income becomes available. For the 1965 fiscal year such deductions exceeded income and therefore no provision for income taxes was required.

4. STATUTORY INFORMATION:

Administrative and general expenses include directors' fees of $10,000 in 1965 and $9,375 in 1964.

5. SUBSEQUENT EVENT:

Subsequent to September 30, 1965 the Company issued and sold $7,500,000 principal amount of 6¼% Convertible Subordinated Debentures due December 15, 1985 for $7,275,000 cash which has been added to the general funds of the Company. The Debentures are convertible, subject to adjustment of conversion prices in certain cases, into shares of capital stock of the Company at any time before December 15, 1970 at $20 per share, and thereafter at any time before December 15, 1975 at $25 per share. The Company has initially reserved 375,000 shares for issuance upon conversion of the Debentures.

The Trust Indenture relating to the Debentures contains certain dividend restrictions providing essentially that dividends may be paid only to the extent of consolidated net earnings accumulated subsequent to September 30, 1965 and net amounts received from the issue of the Company's shares after September 30, 1965.

AUDITORS' REPORT

To the Shareholders of SCURRY - RAINBOW OIL LIMITED:

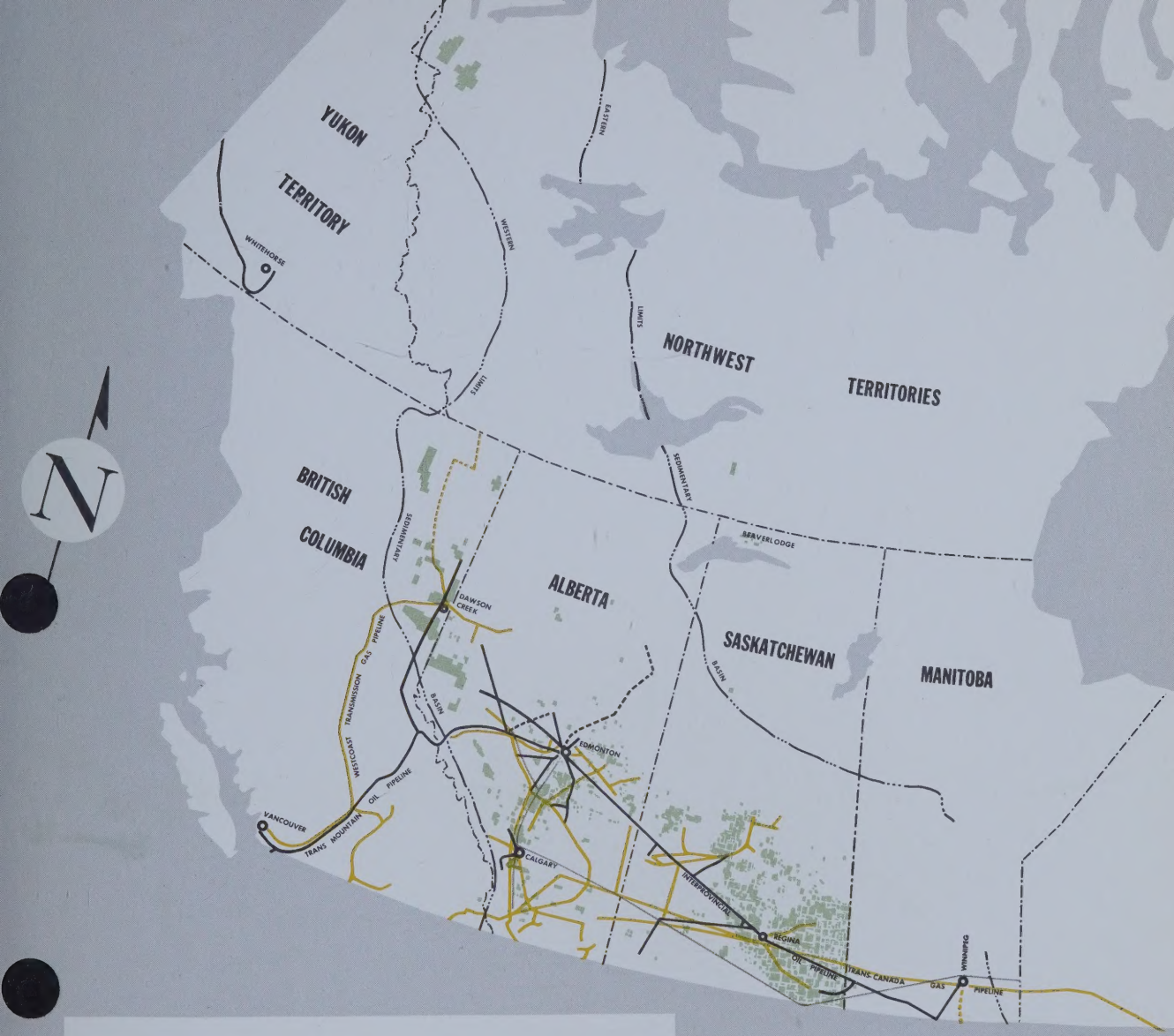
We have examined the consolidated balance sheet of Scurry-Rainbow Oil Limited and subsidiary companies as at September 30, 1965 and the consolidated statement of earnings and retained earnings for the year ended on that date and have obtained all the information and explanations we have required. Our examination was made in conformity with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, and according to the best of our information and the explanations given to us and as shown by the books of the companies, the accompanying consolidated balance sheet and consolidated statement of earnings and retained earnings are properly drawn up so as to exhibit a true and correct view of the state of the affairs of the combined companies as at September 30, 1965 and the consolidated results of operations for the year ended on that date, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year, except for the changes (with which we concur) in accounting for oil and gas properties and crude oil inventories as explained in Note 1 to the financial statements.

We also examined the consolidated statement of source and use of funds for the year ended September 30, 1965 and, in our opinion, the statement presents fairly the information shown therein.

Calgary, Alberta
January 10, 1966

PRICE WATERHOUSE & CO.
Chartered Accountants.



SCURRY-RAINBOW OIL LIMITED

SUMMARY OF ACREAGE

September 30, 1965

	GROSS	NET
WORKING INTEREST ACREAGE		
Reservations and Permits	1,312,992	1,217,052
Petroleum and Natural Gas Leases	1,972,817	519,130
Potash Permits	400,000	400,000
Arctic Island Permits	1,601,591	447,237
MINERAL ACREAGE		
Mineral Titles and Mineral Leases	1,852,837	1,292,927
Oil and Gas Titles	141,432	67,712
ROYALTY ACREAGE		
Gross Royalty in Freehold Land	445,613	71,601
Gross Overriding Royalty on P&NG Leases	456,309	67,789
Gross Overriding Royalty on P&NG Reservations and Permits	40,494	6,797

LEGEND

- GAS PIPELINE
- PROPOSED GAS LINE
- OIL PIPELINE
- PROPOSED OIL LINE
- PROPOSED PRODUCTS LINE
- AREAS IN WHICH SCURRY-RAINBOW HAS AN INTEREST